Highlights

China stepped up its supportive measures to credit market with the latest regulation from banking regulator to instruct banks not to withdraw their lending supports to corporate facing operating difficulty but still able to meet lending criteria against the backdrop of the deceleration of aggregate social financing growth, sluggish economic indicators in July as well as emergence of bond default in local government funding vehicle space. In addition, PBoC also remains supportive to money market with higher than expected longer term liquidity injection via 1-year MLFs and resumption of reverse repo operation.

In the currency market, the sharp turnaround of RMB in the offshore market was mainly attributable to three factors including stronger than expected daily RMB fixing, hopes on easing US-China trade war and expectations on China's possible move to tighten the offshore liquidity. Short sellers unwound their short CNH position in the offshore market after the news broke out that PBoC has suspended some banks's cross border RMB deposit and interbank lending via their FTU accounts in Shanghai free trade zone even though the direct impact on offshore liquidity is not so significant. The memory about China's administrative interventions in 2015-16 currency rout reminded investors more policies may come. As such, market will be more cautious to chase the USDCNY higher in the near term.

On trade war, despite the positive news development last week, we are less optimistic on the outlook. Since Beidaihe meeting in early August, we sense that China has toughened its tone on US-China trade war. Various signs show that top leaders may have reached consensus internally that compromise is not going to solve the problem. The mid-level delegation shows that China does not have high hope for the talk in August. And the new trade talk is more like testing water. Given the shift of official rhetoric on trade war, we think China is unlikely to compromise unilaterally.

In Hong Kong, with HKD frequently touching the weak end of the trading band last week, the HKMA stepped in again to defend the currency peg system. As a result, aggregate balance reduced by HK$16.79 billion to HK$92.6 billion. Due to the fast liquidity drainage, short HKD traders have become cautious. As we get closer to month-end, banks may hoard cash for window dressing and in turn further sideline the short HKD traders. Therefore, we expect aggregate balance hold above HK$80 billion by end of Aug. After month-end, USDHKD may touch 7.85 again given still flushed HKD liquidity and the Fed's gradual rate hikes. However, with HK's twin surpluses and sizeable FX reserve, we expect any capital outflows or liquidity withdrawal to be orderly and gradual. Adding that there is no more mega IPO ahead, we expect HIBOR to go up only moderately. 1M HIBOR and 3M HIBOR will likely test 1.8% and 2% respectively while aggregate balance may hold above HK$50 billion by end of Sep. Lately, all major banks have lifted mortgage rates to ease the pressure on net interest margin. Some banks even reduced HKD fixed-deposit rates following HIBOR's retracement. Against this backdrop, if HIBOR does not rebound to June/July highs, the possibility of prime rate hike in Sep may still be lower than that in Dec. Elsewhere, a new regulation effective 1 Sep will allow residents of Hong Kong, Macao, and Taiwan to apply for residence permits in Mainland China. This combined with the infrastructure improvement will facilitate the collaboration across the Greater Bay Area. Still, we are looking forward to see more privilege policies regarding taxation and home purchase from the development plan of the Greater Bay Area which is about to unveil in the near future.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's Ministry of Commerce announced last week that a delegation led by Vice Commerce Minister Wang Shouwen will visit the US in late August to resume trade negotiation with the delegation led by US undersecretary of Treasury David Malpass.	▪ Since July, China has limited the media coverage on US-China trade war probably due to internal split about the possible reaction with dovish campaign calls for more compromise and stay low key. However, since Beidaihe meeting in early August, we sense that China has toughened its tone on US-China trade war. Various signs show that top leaders may have reached consensus internally. On 10 August, the article published by official People's Daly with title "Understanding the nature of US initiated trade war" addressed the key concern why compromise will not be useful in US-China trade war. This article set the tone, paving the way for more hawkish tone in the mainstream media. ▪ The renewed trade talk gives market hope again on the peaceful solution. However, the mid-level delegation shows that China does not have high hope for the delegation. And the new trade talk is more like testing water. ▪ In conclusion, given the shift of official rhetoric on trade war, we think China is unlikely to compromise unilaterally. As such, the trade war is expected to be prolonged.

▪ China's central bank rolled over the maturing 1-year medium term lending facility (MLF) with higher than expected amount of CNY383 billion. ▪ In addition, PBoC also resumed its reverse repo operation last Friday after suspending for 19 trading days due to flushed liquidity.	▪ China's money market rates went up across the curve last week after having fallen significantly for the past one month. The marginal easing effect has started to diminish as the room for further easing monetary policy is limited. Nevertheless, the higher than expected longer term liquidity injection shows that PBoC will continue to keep money market rates in check to support the real economy.
▪ China's banking and insurance regulator unveiled a new regulation to further ease the credit to serve the real economy more efficiently. The new regulation requires banks not to withdraw the credit support to corporate facing operating difficulty but meeting lending condition.	▪ The new regulation is designed to improve transmission mechanism to channel the funding from money market to credit market to serve the real economy better. This shows that de-leverage has taken a backseat for now with the focus shifts to easing monetary and credit policies. This should provide some supports to the real economy.
▪ The sentiment in China's local government funding vehicle bond space weakened after Xinjiang Production Construction 6th Shi State-owned Assets Management missed the repayment of interest and principle.	▪ Against the backdrop of slowing growth and previous de-leverage campaign, China's default risk is likely to rise further due to poor management of cash flows as a result of mis-investment in the past few years.
▪ The latest date from China's banking regulator shows that China's commercial bank non-performing loan ratio increased further to 1.86% in 2Q, up by 0.11% from 1Q.	▪ The rising NPL ration is the result of the de-leveraging campaign. Nevertheless, given China has dialled back from its aggressive de-leveraging campaign, we think the risk of rising NPLs will ease.
▪ The HKD frequently touched the weak end of the trading band due to rising expectation on wide US-HK yield differential, RMB's weakness and selloff of emerging market assets on Turkey's turmoil. As a result, the HKMA stepped in again to defend the currency peg system by buying a total of HK$16.79 billion. Aggregate balance dropped to HK$92.6 billion.	▪ Due to the fast liquidity drainage, short HKD traders have become cautious. As we get closer to month-end, banks may hoard cash for window dressing and in turn further sideline the short HKD traders. Therefore, we expect aggregate balance hold above HK$80 billion by end of Aug. ▪ After month-end, HKD may touch the weak end of the trading band again given still flushed HKD liquidity and the Fed's gradual rate hikes. However, with HK's twin surpluses and sizeable FX reserve (US$431.9 billion as at the end of July 2018, ranking the 7th across the globe), we expect any capital outflows or liquidity withdrawal to be orderly and gradual. Adding that there is no more mega IPO ahead, we expect HIBOR to go up only moderately. 1M HIBOR and 3M HIBOR will likely test 1.8% and 2% respectively while aggregate balance may hold above HK$50 billion by end of Sep. As such, though the HKMA pledged to inject additional liquidity if necessary with the exchange fund bills which currently amount to HK$1.05 trillion, we think this may not happen until aggregate balance fall to a much lower level like HK$20 billion. ▪ Elsewhere, all major banks have lifted mortgage rates to ease the pressure on net interest margin. Some banks even reduced HKD fixed-deposit rates following HIBOR's retracement. Against this backdrop, if HIBOR does not rebound to June/July highs, the possibility of prime rate hike in Sep may still be lower than that in Dec.
▪ China unveiled a new regulation effective 1 Sep which will allow residents of Hong Kong, Macao, and Taiwan to apply for residence permits in Mainland China.	▪ The residence permits will enable residents of HK, Macau and Taiwan to enjoy basic public services including online ticket purchase and financial services, as well as other rights with regard to employment, social security and housing provident fund. With the permits, they can also enjoy the benefits of compulsory education, health and medical services, as well as legal services. Moreover, they can register their vehicles, apply for driver's licenses and take professional qualification exams. ▪ It is reported that 420 thousands of HK residents are working in Mainland China. On top of the infrastructure improvement, the

	new regulation will attract more residents of HK, Macau and Taiwan to work in Mainland China. This will in turn facilitate the collaboration across the Greater Bay Area. However, with the residence permits, residents of HK, Macau and Taiwan could still find it hard to purchase residential property amid housing control measures. This may impede them from settling down in Mainland China. On the other hand, the new regulation does not specify how the income of the residents of HK, Macau and Taiwan should be taxed if they work in Mainland China. With tax issues remaining unsettled, working in Mainland China may not be very attractive to the residents of HK, Macau and Taiwan.

Key Economic News

Facts	OCBC Opinions
▪ China's economy decelerated further despite easing monetary policy. Infrastructure investment growth in the first seven months slowed to a new record low of 5.5% while industrial production growth remained intact at 6% in July.	▪ The deceleration of fixed asset investment was mainly the result of weak infrastructure investment as a result of tight local government funding due to financial de-leverage. On the positive note, private investment reaccelerated, a sign that China's easing policy may have taken some effect. In addition, manufacturing investment remains resilient despite US-China trade war. Given more easing credit policy and more proactive fiscal policy, we think China's fixed asset investment may bottomed out soon. This may provide floor to the growth.
▪ China's off balance sheet lending shrank further in July despite easing monetary policy as concerns about de-leverage prevail.	▪ Although new Yuan loan remains strong as funding demand shifts back to on-balance sheet. The collapse of off-balance sheet lending led to the further deceleration of aggregate social financing with the total outstanding of social financing growth hit a record low of 10.3% yoy. Given the close correlation between aggregate social financing and nominal GDP growth, the slowdown of social financing growth may weigh down on growth prospect in the second half of 2018.
▪ China's balance of foreign exchange settlement and sales by bank switched to deficit again in July despite foreign exchange purchase by central bank remained positive in the same month. ▪ In addition, long dollar forward position rose to US$35.6 billion in July, highest since August 2015.	▪ The net purchase of dollar by banks in July was mainly the result of recent deprecation of RMB. The divergence between banks' position and central bank's position on foreign currency shows that China's central bank has limited intervention in the spot market. ▪ The rise of long forward position in June and July justified central bank's decision to resume the 20% reserve on long dollar forward position. However, the number is still far short of the level seen in August 2015 when China first announced the reserve policy. This reinforces our view that RMB index 92 is a very important psychological supporting line for regulator.
▪ HK's jobless rate hovered at an over twenty-year low of 2.8% during the three months through July.	▪ Nevertheless, the unemployment rate of trade sector increased from 2.2% to 2.3%. This signals that US-China trade war concerns might have dented the hiring sentiments of the trade sector. On the other hand, the jobless rate of tourism-related sector was up to 4% from 3.9%, the first increase since May 2017. Due to the weaker RMB and the Asia's uncertain economic outlook, tourist spending growth might have been softening and slowing the hiring of the tourism-related sector. Moving forward, we expect China's slowdown and trade fears to continue taming business sentiments. Capital outflows from emerging market amid higher USD rates could also tighten HK's financial condition. All in all, we expect HK's economic growth to slow down in 2H18. As such, unemployment rate is likely to edge up slightly towards 3%.

RMB	
Facts	**OCBC Opinions**
▪ Another roller coaster week for RMB in both onshore and offshore market. CNH recouped all the loss and ended higher last week after the USDCNH hit a high above 6.95. ▪ However, RMB index fell slightly to 92.78 from previous week's 92.91.	▪ The sharp turnaround of RMB in offshore market last Friday was mainly attributable to three factors including stronger than expected daily RMB fixing, hopes on easing US-China trade war and expectations on China's possible policy to tighten the offshore liquidity. ▪ Short sellers unwound their short CNH position in the offshore market due to concerns about tightened RMB liquidity in the offshore market after the news broke out that PBoC has suspended some banks's cross border RMB deposit and interbank lending via their FTU accounts in Shanghai free trade zone. As such, CNH liquidity tightened with the CNH swap pointed moved upwards across the curve. Although the direct impact on offshore liquidity is unlikely to be significant, the signal is pretty strong that China has shifted their attention to currency stability. With the much stronger than expected daily fixing in the past few days and improving sentiment on US-China trade talk, market will be more cautious to chase the USDCNY higher in the near term.

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